UT 02-6
Tax Type: Use Tax
Issue: Use Tax On Aircraft Purchase

STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
CHICAGO, ILLINOIS

THE DEPARTMENT OF REVENUE	)	Docket No. 00-ST-0000
OF THE STATE OF ILLINOIS	)	IBT No. 0000-0000
v.	)	NTL No. 00000000000000000
ABC LEASING, INC.,	)	
	)	John E. White,
Taxpayer.	)	Administrative Law Judge

RECOMMENDATION FOR DISPOSITION

Appearances: Brian Wolfberg, Schain, Burney Ross & Citrin, Ltd., appeared for ABC Leasing, Inc.; Rebecca Kulekowskis and Gary Stutland, Special Assistant Attorneys General appeared for the Illinois Department of Revenue

Synopsis:

This matter involves the Illinois Department of Revenue's ("Department") issuance of a Notice of Tax Liability ("NTL") to ABC Leasing, Inc. ("ABC") regarding its lease of an aircraft to another corporation for a six-week period in 1997. The NTL assessed tax on ABC's ownership and use of the aircraft it leased, pursuant to Illinois' Use Tax Act ("UTA"). For most of the lease period, the lessee kept and flew the aircraft in Illinois.

The parties agreed to proceed via a stipulated record, including a stipulation of facts and stipulated records, in lieu of hearing. After considering the record, I am including in this recommendation findings of fact and conclusions of law. I recommend that the matter be resolved in favor of taxpayer.

Findings of Fact:

1. ABC is an Arizona corporation that is engaged in the business of leasing airplanes and trucks to ABC carriers for hire and others. Stipulated Facts ("Stip."), ¶¶ 6-7; Stip. Ex. 5 (copy of ABC lease).

2. ABC's principle place of business is in Anywhere, Arizona. Stip. ¶ 8.

3. ABC also has offices in Oregon and in Wisconsin. Stip. ¶ 9. It leases trucks out of its Wisconsin office. Stip. ¶ 10.

4. During the audit period, ABC:

   - was not registered to do business in Illinois;
   - had no offices or facilities in Illinois;
   - did not solicit any business in Illinois and did not advertise for business in Illinois;
   - did not own any real estate situated in Illinois;
   - did not employ any personnel who worked in Illinois;
   - did not hangar any aircraft or maintain any equipment in Illinois.

   Stip. ¶¶ 11, 13-17; *see also* 735 **ILCS** 5/2-209 (Illinois' long arm statute).

5. On May 15, 1995, ABC purchased a Cessna VI model 650 aircraft from the Cessna Aircraft Co, which was assigned a registration number of 000000 by the Federal Aviation Administration ("FAA"). Stip. ¶ 19. ABC retained ownership of and title to that aircraft throughout the audit period. Stip. ¶ 20.

6. On March 18, 1997, ABC, as lessor, entered into an Aircraft Lease Agreement (hereinafter, "lease") with XYZ Management Co. ("XYZ") as lessee. Stip. ¶ 21; Stip. Ex. 5.

7. John Doe, XYZ's Director of Aviation, signed the lease for XYZ. Stip. Ex. 5, p. 5. Doe also certified that he was responsible for the operation control of the

aircraft during the lease period, and that he understood his responsibilities for complying with applicable FAA regulations, and gave his address as Anywhere, Connecticut. *Id*.

8. The address Doe gave as his own is the same address designated as the address for notices required by the lease to be given to XYZ. *Compare* Stip. Ex. 5, p. 3 *with id*., p. 5.

9. The lease term was from March 21, 1997 to May 2, 1997. Stip. ¶ 22.

10. ABC delivered the aircraft to XYZ in Kansas, after flying it there from Anywhere, Arizona. Stip. ¶ 23; Stip. Ex. 6 (copy of aircraft flight log for leased aircraft).

11. Upon receipt of the aircraft, XXXXX signed an Aircraft Delivery Acceptance Receipt for XYZ. Stip. Ex. 5, p. 7.

12. After taking delivery and possession of the aircraft, XYZ flew it from Wichita to an airport in Illinois. Stip. ¶ 23.

13. XYZ kept the aircraft in Illinois 39 of the 43 days of the lease term, and it flew the aircraft into and/or out of Illinois airports 26 times during that period. Stip. ¶¶ 24-25.

14. On May 2, 1997, XYZ redelivered possession of the aircraft to ABC by having it flown from Wisconsin to Kansas. Stip. ¶ 26. Following its receipt of the aircraft, ABC signed an Aircraft Delivery Acceptance Receipt. Stip. Ex. 5, p. 10.

Conclusions of Law:

The Illinois General Assembly incorporated into the UTA certain provisions of the Retailers' Occupation Tax Act ("ROTA"). 35 **ILCS** 105/11. Among them is § 4 of the ROTA, which provides that the Department's determination of tax due constitutes prima facie proof that tax is due in the amount determined by the Department. 35 **ILCS** 105/11; 35 **ILCS** 120/4. The parties included, as part of their stipulated record, a copy of the Department's Audit Correction and/or Determination of Tax Due, which was prepared following an audit of ABC's business. Stip. Ex. 1. That exhibit, without more, constitutes prima facie proof that ABC owes Illinois use tax in the amount determined by the Department. 35 **ILCS** 105/11; 35 **ILCS** 120/4. The Department's prima facie case is overcome, and the burden shifts to the Department to prove its case, when a taxpayer presents evidence that is consistent, probable and identified with its books and records, to show that the Department's determinations were not correct. Copilevitz v. Department of Revenue, 41 Ill. 2d 154, 157-58, 242 N.E.2d 205, 207 (1968).

Section 2 of the UTA defines "use" as "the exercise by any person of any right or power over tangible personal property incident to the ownership of that property, ***." 35 **ILCS** 105/2. The Illinois supreme court has interpreted § 2 to mean that persons who lease tangible personal property (hereinafter, "goods") for use in Illinois are the legal users of the goods they lease. Telco Leasing , Inc. v. Allphin, 63 Ill. 2d 305, 310, 347 N.E.2d 729, 731 (1976); Philco Corp. v. Department of Revenue, 40 Ill. 2d 312, 317-18, 239 N.E.2d 805, 809 (1968). Therefore, such persons are subject to pay use tax as measured by the cost price of the goods they lease for use in Illinois. Telco Leasing , Inc., 63 Ill. 2d at 310, 347 N.E.2d at 731; Philco, 40 Ill. 2d at 317-18, 239 N.E.2d at 809.

The question presented by this case is whether an out-of-state lessor owes use tax on goods that one of its lessees brings into Illinois, where there is no evidence that the lessor knew that the goods were going to be used in Illinois. ABC asserts three reasons why the Department's tax assessment was incorrect. First, it argues that, because it lacks minimum contacts with Illinois, the Department lacks personal jurisdiction over it sufficient to render a decision on the merits of this matter. Second, and closely tied to the first issue, ABC contends that it has never purposefully directed any activity towards Illinois sufficient for Illinois to have jurisdiction, under the Due Process Clause, to tax ABC's use of the airplane it leased to XYZ in 1997. Finally, ABC argues that, since it lacks substantial nexus with Illinois, the Department's assessment of use tax against it violates the Commerce Clause of the United States Constitution. In each case, the Department counters that the assessment was correct and premised upon ABC's activities within Illinois, i.e., its lease of the aircraft to someone who used it in Illinois.

Issues I: Illinois' Jurisdiction Over the Person of ABC

The first issue involves Illinois' power to make ABC come into the state to defend itself regarding this tax dispute. ABC's first argument, that Illinois lacks jurisdiction over its person, consists of a repetition of the arguments set forth in its motion to dismiss, which was presented days before the first hearing date set in this matter. That motion was denied by an order dated 4/17/02, and I incorporate into this recommendation the bases for denying that motion.

To summarize, the order noted that objections to a court's jurisdiction over the person of a named defendant can be waived, and concluded that ABC's actions during the course of the administrative review process it requested constituted an objective

manifestation of its submission to the Department's authority to make a decision on the merits in this tax dispute. The facts cited to support ABC's waiver, or its submission to Illinois' authority to resolve the dispute, included: ABC's taking part in five status conferences held over the course of a year in this matter, as well as the pre-hearing conference; ABC's combination of its motion to dismiss with a motion to continue the hearing in this matter; and, notwithstanding ABC's current (and factually uncorroborated) claim that no discovery was conducted in this matter, the parties' assertion, during one status conference in this matter, that whatever discovery was needed *had* been conducted. By failing to immediately perform the acts required by persons who claim the benefit of § 2-301 of the Illinois Code of Civil Procedure, and by its own affirmative actions thereafter, ABC submitted to Illinois' authority to make a decision on the merits in this contested tax dispute. 4/17/02 Order; *see also* Pearson v. Lake Forest Country Day School. 262 Ill. App. 3d 228, 233-34, 633 N.E.2d 1315, 1318-19 (2d Dist. 1994).

Of course, and as indicated in the order denying ABC's motion to dismiss, ABC's waiver of its personal jurisdiction objection does not mean that the issue is no longer before the agency. Rather, it is the primary issue in this contested case, and is the subject of the next section of this recommendation.

Issue II: Illinois' Jurisdiction To Tax ABC's Use Of Its Aircraft

Before addressing the facts of this case, it will help to review some basic tenets of due process jurisprudence. In Quill Corp. v. North Dakota, the United States Supreme

Court reaffirmed the principle that "[t]he Due Process Clause 'requires some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax ….' " Quill Corp. v. North Dakota, 504 U.S. 298, 306, 112 S.Ct. 1904, 1909, 119 L.Ed.2d 91 (1992) (*quoting* Miller Brothers Co. v. Maryland, 347 U.S. 340, 344-45, 74 S.Ct. 535, 539, 98 L.Ed. 744 (1954)). Quill involved North Dakota's attempt to require an out-of-state mail-order seller of office equipment, Quill, to collect use tax from its North Dakota customers, and pay over to the state that tax as measured by the gross receipts it realized from the goods it sold to such residents and shipped into North Dakota.

The Court in Quill began its decision by stating that it was heeding Justice Rutledge's opinion in International Harvester Co. v. Department of Treasury, 322 U.S. 340, 353, 64 S.Ct. 1019, 1032-1033, 88 L.Ed. 1313 (1944) (Rutledge, J., concurring in part and dissenting in part), in which he wrote that:

> " 'Due process' and 'commerce clause' conceptions are not always sharply separable in dealing with these problems. ... To some extent they overlap. If there is a want of due process to sustain the tax, by that fact alone any burden the tax imposes on the commerce among the states becomes 'undue.' But, though overlapping, the two conceptions are not identical. There may be more than sufficient factual connections, with economic and legal effects, between the transaction and the taxing state to sustain the tax as against due process objections. Yet it may fall because of its burdening effect upon the commerce. And, although the two notions cannot always be separated, clarity of consideration and of decision would be promoted if the two issues are approached, where they are presented, at least tentatively as if they were separate and distinct, not intermingled ones."

Quill, 504 U.S. at 305-06, 112 S.Ct. at 1909. Thereafter, the Quill Court held that "a corporation may have the 'minimum contacts' with a taxing State as required by the Due

Process Clause, and yet lack the 'substantial nexus' with that State as required by the Commerce Clause." Quill, 504 U.S. at 313, 112 S.Ct. at 1913-14.

For due process purposes, the Quill Court equated a state's jurisdiction to tax a foreign corporation on its commercial activities within the state with the state's judicial jurisdiction, that is, its power to make a foreign corporation come into the state and defend against a lawsuit initiated there. *Id*. (discussing International Shoe Co. v. Washington, 326 U.S. 310, 66 S.Ct. 154, 90 L.Ed. 95 (1945)). The Court reaffirmed its prior holding that, "if a foreign corporation purposefully avails itself of the benefits of an economic market in the forum State, it may subject itself to the State's in personam jurisdiction even if it has no physical presence in the State." Quill, 504 U.S. at 307, 112 S.Ct. at 1910, 1911. "So long as a commercial actor's efforts are 'purposefully directed' toward residents of another State, we have consistently rejected the notion that an absence of physical contacts can defeat personal jurisdiction there." *Id*., (*quoting* Burger King Corp. v. Rudzewicz, 471 U.S. 462, 476, 105 S.Ct. 2174, 2184, 85 L.Ed.2d 528 (1985). The Supreme Court held that North Dakota's attempt to make Quill collect use tax from customers regarding its sales into the state satisfied due process concerns, since it had purposefully directed, *inter alia*, more than 24 tons of catalogues and flyers into the state during the applicable period in an attempt to solicit sales to North Dakota residents and domiciliaries. Quill, 504 U.S. at 304, 308, 112 S.Ct. at 1909, 1911. Specifically, the court held:

> In this case, there is no question that Quill has purposefully directed its activities at North Dakota residents, that the magnitude of those contacts is more than sufficient for due process purposes, and that the use tax is related to the benefits Quill receives from access to the State. We therefore agree with the North Dakota Supreme

> Court's conclusion that the Due Process Clause does not bar enforcement of that State's use tax against Quill.

Quill, 504 U.S. at 308, 112 S.Ct. at 1911.

The final principle to discuss before moving on to applicable Illinois law is that, for a forum state to have judicial jurisdiction over a potential defendant's person, it must be the *defendant itself* that purposefully directs activities toward the forum state. This principle was the focus of the Court's decision in Asahi Metal Industry Co., Ltd. v. Superior Court of California, Solano Co., 480 U.S. 102, 107 S.Ct. 1026, 94 L.Ed.2d 92 (1987). There, the Court took pains to describe how its earlier decision in World-Wide Volkswagon Corp. v. Woodson, 444 U.S. 286, 100 S.Ct. 559, 62 L.Ed.2d 490 (1980) had led lower courts to take two distinct approaches when determining whether an out-of-state defendant's actions subjected it to the state's judicial jurisdiction. The Court described the split this way:

> Applying the principle that minimum contacts must be based on an act of the defendant, the Court in *World-Wide Volkswagen Corp. v. Woodson*, 444 U.S. 286, 100 S.Ct. 559, 62 L.Ed.2d 490 (1980), rejected the assertion that a *consumer's* unilateral act of bringing the defendant's product into the forum State was a sufficient constitutional basis for personal jurisdiction over the defendant. It had been argued in *World-Wide Volkswagen* that because an automobile retailer and its wholesale distributor sold a product mobile by design and purpose, they could foresee being haled into court in the distant States into which their customers might drive. The Court rejected this concept of foreseeability as an insufficient basis for jurisdiction under the Due Process Clause. *Id.*, at 295-296, 100 S.Ct., at 566. The Court disclaimed, however, the idea that "foreseeability is wholly irrelevant" to personal jurisdiction, concluding that "[t]he forum State does not exceed its powers under the Due Process Clause if it asserts personal jurisdiction over a corporation that delivers its products into the stream of commerce with the expectation that they will be purchased by consumers in the forum

State." *Id.*, at 297-298, 100 S.Ct., at 567 (citation omitted).
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In *World-Wide Volkswagen* itself, the state court sought to base jurisdiction not on any act of the defendant, but on the foreseeable unilateral actions of the consumer. Since *World-Wide Volkswagen*, lower courts have been confronted with cases in which the defendant acted by placing a product in the stream of commerce, and the stream eventually swept defendant's product into the forum State, but the defendant did nothing else to purposefully avail itself of the market in the forum State. Some courts have understood the Due Process Clause, as interpreted in *World-Wide Volkswagen*, to allow an exercise of personal jurisdiction to be based on no more than the defendant's act of placing the product in the stream of commerce. Other courts have understood the Due Process Clause and the above-quoted language in *World-Wide Volkswagen* to require the action of the defendant to be more purposefully directed at the forum State than the mere act of placing a product in the stream of commerce.

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We now find this latter position to be consonant with the requirements of due process. The "substantial connection," *Burger King*, 471 U.S., at 475, 105 S.Ct., at 2184; *McGee*, 355 U.S., at 223, 78 S.Ct., at 201, between the defendant and the forum State necessary for a finding of minimum contacts must come about by *an action of the defendant purposefully directed toward the forum State. Burger King, supra*, 471 U.S., at 476, 105 S.Ct., at 2184; *Keeton v. Hustler Magazine, Inc.*, 465 U.S. 770, 774, 104 S.Ct. 1473, 1478, 79 L.Ed.2d 790 (1984). The placement of a product into the stream of commerce, without more, is not an act of the defendant purposefully directed toward the forum State. Additional conduct of the defendant may indicate an intent or purpose to serve the market in the forum State, for example, designing the product for the market in the forum State, advertising in the forum State, establishing channels for providing regular advice to customers in the forum State, or marketing the product through a distributor who has agreed to serve as the sales agent in the forum State. But a defendant's awareness that the stream of commerce may or will sweep the product into the forum State does not convert the mere act of placing the product into the stream into an act purposefully directed toward the forum State.

Asahi, 480 U.S. at 109-112, 107 S.Ct. at 1030-32 (emphasis original). With those foregoing fundamental principles in mind, it is time to address the facts and the applicable Illinois statutes involved here.

Once a court has interpreted a particular statutory provision, that interpretation becomes part of the statute, unless the legislature subsequently amends the statute to change it. Kroger v. Department of Revenue, 284 Ill. App. 3d 473, 480, 673 N.E.2d 710, 714 (1st Dist. 1996) (*citing* Miller v. Lockett, 98 Ill. 2d 478, 483, 457 N.E.2d 14 (1983)). Thus, the Illinois supreme court's holding in Philco, that out-of-state "lessors of personal property who lease[ ] their [property] for use in Illinois, … use[ ] that [property] in Illinois within the meaning of section 2 of the Use Tax Act" (Philco, 40 Ill. 2d at 317-18, 239 N.E.2d at 809), is substantive Illinois law. The statutory tax issue in this case, therefore, is whether ABC used its aircraft in Illinois by leasing it to others for use in Illinois. Intertwined with this substantive tax issue is the jurisdictional question — whether ABC purposefully directed activities toward Illinois sufficient to bring it within Illinois' tax jurisdiction. Since, following the holding in Quill, Illinois' jurisdiction to impose a privilege tax on ABC's commercial activities within Illinois is coextensive with its judicial jurisdiction, it is also helpful to review § 2-209 of Illinois' Code of Civil Procedure, which is Illinois' long-arm statute.

Section 2-209 details the types of conduct by ABC that would subject it to Illinois' judicial jurisdiction. The pertinent parts of that section provide:

> § 2-209. Act submitting to jurisdiction - Process.
> (a) Any person, whether or not a citizen or resident of this State, who in person or through an agent does any of the acts hereinafter enumerated, thereby submits such person, and, if an individual, his or her personal

> representative, to the jurisdiction of the courts of this State as to any cause of action arising from the doing of any of such acts:
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> (1) The transaction of any business within this State;
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> ***
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> (7) The making or performance of any contract or promise substantially connected with this State;
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> (10) The acquisition of ownership, possession or control of any asset or thing of value present within this State when ownership, possession or control was acquired;
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> (b) A court may exercise jurisdiction in any action arising within or without this State against any person who:
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> ***
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> (3) Is a corporation organized under the laws of this State; or
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> (4) Is a natural person or corporation doing business within this State.
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> (c) A court may also exercise jurisdiction on any other basis now or hereafter permitted by the Illinois Constitution and the Constitution of the United States.
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735 **ILCS** 5/2-209.

The record submitted in lieu of hearing in this case includes the parties' stipulation to the following relevant facts. ABC purchased the aircraft in 1995. Stip ¶ 19. ABC entered into a lease of the aircraft with XYZ, a Delaware corporation, with a Delaware business address, in March 1997. Stip. ¶ 21; Stip. Ex. 5. ABC did not deliver the aircraft to XYZ in Illinois. Stip. ¶ 23; Stip. Ex. 6, p. 1. Rather, ABC delivered the aircraft to XYZ outside Illinois, and XYZ, thereafter, flew the aircraft into and out of Illinois during the lease period. Stip. ¶ 23; Stip. Ex. 6, p. 1. During the time when ABC leased the aircraft to XYZ, ABC: was not registered to do business in Illinois; had no offices or facilities in Illinois; did not solicit any business in Illinois; did not advertise for business in Illinois; did not own any real estate situated in Illinois; did not employ any

personnel who worked in Illinois; and did not hangar any aircraft or maintain any equipment in Illinois. Stip. ¶¶ 11, 13-17; *see also* 735 **ILCS** 5/2-209. In addition to their agreement with the foregoing facts, the parties also stipulated that if ABC's president, XXXXX, were called as a witness at hearing, he would testify that, "[ABC] had no … knowledge of the destination, use or routing of the Aircraft during the lease period of March 21, 1997 through May 2, 1997." Stip., pp. 3-4, ¶¶ 2, 2c. Finally, there is no evidence showing, and no claim that, ABC took delivery of the aircraft in 1995 in Illinois. 35 **ILCS** 105/4 (delivery of goods into Illinois constitutes prima facie evidence that the goods were purchased for use in Illinois).

Despite the Department's agreement to include XXXXX' affidavit as part of the parties' stipulated record (Stip. p. 3, ¶ 2), the Department disputes XXXXX' stipulated averment that ABC did not know where ABC would be using the aircraft during the lease period. Indeed, the Department's principle argument on this due process issue is that, "[ABC,] by its billing system and maintenance responsibilities knew precisely where and when its aircraft had flown during the lease." Department's Responsive Brief ("Department's Brief"), p. 6. The Department's argument is premised on the following assertions of fact:

> … The Taxpayer/Lessor billed the Lessee monthly. The Taxpayer/Lessor used the Aircraft's flight log in order to determine the Lessee's base rent and in order to determine the Engine Maintenance Service Plan cost to bill the Lessee. At all times before, during and after the Lease, the Taxpayer was responsible for maintaining the Aircraft's flight logs. Generally, the Aircraft's flight log detailed: (1) the dates the Aircraft was flown; (2) what airports the Aircraft flew out of and into; (3) what time the Aircraft departed and arrived; (4) the Hobbs meters (i.e., mileage [*sic*] on the Aircraft); and (5) who was flying the Aircraft. ***

Department's Brief, p. 6.[1]

The Department's phrasing suggests that ABC discovered XYZ was using its aircraft in Illinois after the lease was executed, but while the lease was executory. *Id*. ("[ABC] used the Aircraft's flight log in order to determine the Lessee's base rent and in order to determine the Engine Maintenance Service Plan cost to bill the Lessee. … [ABC,] by its billing system and maintenance responsibilities knew precisely where and when its Aircraft *had flown* during the Lease.") (emphasis added). As will be discussed shortly, the record evidence more properly suggests that ABC discovered XYZ's base of operations and flight itinerary only *after* the lease term was completed, rather than during the period when the lease was executory. But the point I address immediately concerns the Department's conclusion that ABC knew that XYZ was using the aircraft in Illinois because ABC received copies of the aircraft flight logs *prior to* billing XYZ during the lease term. *Id*.

Were that the case, or more accurately, were it the case that ABC knew, *before or when the lease was executed*, that XYZ intended to use the aircraft in Illinois, then the Department's use tax assessment would be on more solid ground. At a minimum, a lessor who knows that it is leasing goods to a person who will use them in Illinois meets the UTA's statutory definition of use, as interpreted by the Illinois supreme court in Philco.

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[1] A Hobbs Meter measures time, not distance. The most common type of Hobbs meter measures engine operating time, in 1/10th hour increments, from the time an aircraft engine is started to the time the engine is shut off. *See, e.g.*, http://www.airfleettraining.com/glossary.html. Other Hobbs meters measure what the FAA refers to as "time in service" (14 C.F.R. § 1.1 (defined as "the time from the moment an aircraft leaves the surface of the earth until it touches it at the next point of landing")) and what ABC's lease refers to as "flight hours." Stip. Ex. 5, ¶¶ 3, 5 (hourly rental charge based on flight hours, meaning the time from takeoff to landing).

Under those circumstances, moreover, ABC would clearly be purposefully directing its economic leasing activities toward Illinois. It would have purposefully entered into a contract to transfer use and possession of its aircraft to a commercial actor who, it knew, would be using the aircraft in Illinois airspace, with all of the foreseeable risks and benefits attendant thereto. As the United States Supreme Court noted in Quill, the Due Process Clause's " 'minimum contacts' requirement … [is] a proxy for notice …." Quill, 504 U.S. at 313, 112 S.Ct. at 1913. Under Burger King Corp. v. Rudzewicz, ABC's knowing lease of an aircraft to a person for use in Illinois would constitute "some act by which the defendant purposefully avails itself of the privilege of conducting activities within the forum State, thus invoking the benefits and protections of its laws."[2] Burger King Corp., 471 U.S. at 475, 105 S.Ct. at 2183.

The rule reaffirmed in Asahi was that a "forum state does not exceed its powers under the Due Process Clause if it asserts personal jurisdiction over a corporation that delivers its products into the stream of commerce with the expectation that they will be purchased by consumers in the forum state." Asahi, 480 U.S. at 109, 107 S.Ct. at 1031 (*quoting* World-Wide Volkswagon Corp. v. Woodson, 444 U.S. 286, 297-98, 100 S.Ct. 559, 567 (1980)). Asahi suggests no constitutional difference between a seller who knows its goods will be sold to purchasers in a forum state and a lessor who knowingly

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[2] And if ABC's knowing agreement to lease goods to XYZ for use in Illinois were not sufficient to invoke Illinois' general jurisdiction over ABC's person, that single intentional act would still give the Department specific jurisdiction over ABC's person sufficient to tax ABC's knowing use of its goods in Illinois, as "use" is defined in the UTA. *See* Helicopteros Nacionales de Colombia, S.A. v. Hall, 466 U.S. 408, 414 n.8, 416 n.9, 104 S.Ct. 1868, 80 L.Ed.2d 404 (1984) (Specific jurisdiction refers to jurisdiction over a defendant in a suit arising out of or related to the defendant's contacts with the forum. General jurisdiction refers to suits that neither arise out of nor are related to the defendant's contacts and is permitted only where the defendant has continuous and systematic general business contacts with the forum state); Philco, 40 Ill. 2d at 317-18, 239 N.E.2d at 809.

enters into a lease of goods with one who, it knows, will use the goods in a forum state. Both knowingly target their own economic activities to persons who intend to use the purchased or leased goods in a particular forum.

And from Illinois' perspective, it should not be forgotten that one of the Illinois General Assembly's specific purposes when enacting Illinois' use tax was to place out-of-state retailers who sell goods for use or consumption in Illinois, and out-of-state lessors who lease goods to persons for use in Illinois, on a level playing field with similarly situated Illinois-based retailers and lessors. Klein Town Builders v. Department of Revenue, 36 Ill. 2d 301, 222 N.E.2d 482 (1967); *see also* Philco, 40 Ill. 2d at 317-18, 239 N.E.2d at 809. A lessor's purposeful execution of a lease to a lessee whom the lessor knows will use its goods in Illinois constitutes the lessor's exercise of rights and powers over such goods in Illinois, incidental to its ownership of such goods. Telco Leasing, Inc., 63 Ill. 2d at 310, 347 N.E.2d at 731. Finally, had ABC known that it was leasing the aircraft to XYZ for use in Illinois, it would be making a contract that is substantially connected with Illinois. 735 **ILCS** 5/2-209(a)(7), (c); Viktron Limited Partnership v. Program Data Inc., 326 Ill. App. 3d 111, 117-20, 759 N.E.2d 186, 193-95 (2nd Dist. 2001) (when considering whether a contract is substantially connected with Illinois, one must determine where performance was contemplated). In short, had ABC known that its lease with XYZ was a lease of goods for use in Illinois, it would not offend "traditional notions of fair play and substantial justice" to require ABC to defend against a state claim that ABC exercised the privilege of using, in Illinois, goods purchased at retail for use or consumption. Quill, 504 U.S. at 308, 112 S.Ct. at 1911; Philco, 40 Ill. 2d at 317-18, 239 N.E.2d at 809.

That said, I must nonetheless acknowledge that nothing in this stipulated record supports the Department's assertion that ABC knew, either before or during the lease term, that XYZ would be using the aircraft in Illinois. First of all, ABC's president expressly denies that ABC had any such knowledge during the lease term. Stip., p. 3, ¶ 2. Second, and more important than XXXXX' mere denial of knowledge, the only competent evidence of record, ABC's books and records, tends to corroborate the truth of XXXXX' averment, and tends to disprove the truth of the Department's fact assertions. J.H. Walters Co. v. Department of Revenue, 44 Ill. 2d 95, 105, 254 N.E.2d 485, 491 (1969). The pertinent parts of ABC's lease provide:

> 2. LEASE TERM. LESSEE hereby agrees to lease the Aircraft on an as needed basis from LESSOR for an hourly amount in accordance with the terms hereof, from March 21, 1997, for a period of six (6) consecutive weeks ending May 2, 1997. Should additional time be required by LESSEE to accomplish necessary maintenance prior to delivery of aircraft to LESSOR or LESSEE requires additional lease time, this extension shall be mutually agreed to by both parties.
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> 3. RENT. LESSEE hereby agrees to pay rent to LESSOR based upon the rate $1,550.00 per flight hour ("dry"). In addition, LESSEE shall pay the Engine Maintenance Service Plan ("MSP") of $220.50 per flight hour for both engines to LESSOR. LESSEE agrees to pay the cost of all crew, fuel and replacement oil, lubricants and additives.
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> 4. PAYMENT OF RENT. LESSOR shall invoice LESSEE each month for the previous month's rent, based on the number of hours flown the previous month by LESSEE. LESSEE shall pay LESSOR'S invoice for rent with thirty (30) days of receipt of invoice by LESSEE.
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> 5. HOURS. The hourly charges shall be calculated on the time from takeoff to landing at destination of each leg of the trip. LESSEE agrees to guarantee a minimum of 100 flight hours during the term of this agreement. LESSOR

> shall maintain accurate aircraft and engine logs for the Aircraft and make them available for examination by LESSEE. LESSOR shall have the right to confirm the flight hours by examination of pertinent pilot flight, aircraft logs and/or Aircraft Hobbs meter.

Stip. Ex. 5, ¶¶ 2-5.

The plain text of the lease requires XYZ to notify ABC of the number of flight hours XYZ used during each month. Stip. Ex. 5, ¶ 2. But it would only be in the event that ABC affirmatively sought to examine the aircraft's flight logs that XYZ would be required to make them available to ABC. Stip. Ex. 5, ¶ 5. Thus, the lease does not support the Department's implied assertion that, at the end of March and then at the end of April 1997, XYZ actually tendered to ABC copies of the flight logs XYZ maintained during the lease. Nor does it support the Department's express assertion that ABC used copies of logs XYZ supplied it with to calculate its monthly bill to XYZ. This stipulated record contains no competent evidence that either XYZ or ABC did what the Department says they did.[3]

With regard to whether ABC purposefully directed any activities toward Illinois, all the stipulations and documentary evidence included in this record are similarly consistent with ABC's argument that it did nothing to purposefully direct activities toward Illinois, Illinois' economic market, or toward Illinois' residents. As ABC argues, the evidence shows that it was XYZ, and not ABC, that had contacts with Illinois during

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[3] In its reply brief, and in response to the Department's assertion that ABC prepared its bills to XYZ using copies of the aircraft logs that XYZ gave it at the end of each month, counsel for ABC stated that, for purposes of billing, XYZ provided it with only the number of flight hours. Taxpayer's Reply Brief ("Taxpayer's Reply"), p. 2. But neither the Department's assertions of fact, nor ABC's reply, constitute evidence. Only the stipulated record constitutes evidence, and that evidence simply does not describe how XYZ notified ABC of the number of flight hours it used each month of the lease term, or what data ABC used to prepare its monthly bills to XYZ.

the lease term.[4] ABC did not deliver the aircraft to XYZ in Illinois. Nor did it have pilots come into Illinois to fly the aircraft when the lease was over. The lease was not entered into in Illinois, and ABC did not advertise in Illinois. There is simply no evidence in the record showing that ABC knew — pre-execution — that XYZ would be taking off from, landing, or hangaring ABC's aircraft in Illinois during the lease term.

Thus, the facts here are unlike the facts in Philco or in Quill. Regarding Philco, there were two out-of-state lessors in that consolidated case. The first, Philco, was a Pennsylvania corporation that leased a computer system to an Illinois lessee. The lease was executed in Pennsylvania and it required Philco to install and set up the system at the lessee's Illinois location. It also required Philco to maintain the system, which was

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[4] The Department argues that ABC had sufficient contacts with Illinois to satisfy due process because, "by using its Aircraft in Illinois, [ABC] should have registered with the State." Department's Brief, pp. 10-11. On this point, the parties stipulated that "ABC never registered to do business in the State of Illinois" (Stip ¶ 11), but they never identified what particular type of registration they were talking about. When making its argument that ABC should have registered with the State, the Department continues that ambiguity by failing to cite to any particular statutory provision — or even to any particular act — that would require ABC to register with Illinois. I note that, under the UTA, "retailers maintaining a place of business in Illinois" are required to register with the Department for use tax collection purposes, and "retailers not maintaining a place of business in Illinois," are permitted to register with the Department, for the same reason. 35 **ILCS** 105/6. The Department, however, has stipulated that ABC is a lessor (Stip. ¶ 7), and it never offered any evidence to show that it is a retailer, too. If ABC owes use tax in this case, moreover, it is because it used its goods in Illinois, not because it should have collected use tax from someone else. *See* Philco, 40 Ill. 2d at 317-18, 239 N.E.2d at 809. Taxable users are required to register with the Department only if they have a frequently recurring direct use tax liability. 86 Ill. Admin. Code § 150.701(b). Nothing in this record suggests that ABC is such a user.

Alternatively, I note that Illinois' Business Corporation Act requires a foreign corporation to register with the Illinois Secretary of State before it transacts business within Illinois. 805 **ILCS** 5/13.05 ("a foreign corporation organized for profit, before it transacts business in this State, shall procure authority so to do from the Secretary of State."). That act, however, also defines "Activities that do not constitute transacting business." 805 **ILCS** 5/13.75. Two such activities are "owning, without more, real or personal property [within Illinois]" and "conducting [within Illinois] an isolated transaction that is completed within 120 days and that is not one in the course of repeated transactions of a like nature …." 805 **ILCS** 5/13.75(9)-(10). Suffice it to say, the Department has failed to support, with either fact or law, its assertion that ABC "should have registered with [Illinois]."

achieved by employing two engineers at the lessee's location. The lease was for a term of six years and required the lessee to return the system to Philco when the lease term was over. The second lessor in Philco was Rental Equipment Corp. ("Rental"), a Missouri corporation that rented heavy construction equipment, some of it to persons who used the equipment on construction projects in Illinois. Rental's leases to Illinois users were executed in Missouri and the equipment was delivered to the customers at Rental's Missouri yard. Pursuant to those leases, Rental was allowed to enter the property where the lessee kept the leased equipment and retake it, without legal process in the event of abuse, neglect or strikes. For leases of equipment for use in Illinois, the leases prohibited a lessee from removing the equipment from Illinois without written permission from Rental. As a courtesy to its lessees, Rental also arranged to have qualified persons operate the equipment in Illinois, and on rare occasions, such persons would be paid by Rental. Philco, 40 Ill. 2d at 314-15, 239 N.E.2d at 807. At a minimum, therefore, each lessor in Philco had actual knowledge that its equipment was being leased to others for use in Illinois.[5]

Here, however, the stipulated facts and evidence in this case support ABC's claim that it did *not* know that XYZ would be using its aircraft in Illinois. Stip. p. 3, ¶ 2; Stip. 5; ABC's Memorandum of Law ("ABC's Brief"), p. 7. And unlike the case in Quill, ABC conducted no direct or general advertising to residents, domiciliaries or potential lessees in Illinois. Stip. ¶ 15. Even though Quill had no physical presence in North Dakota, the

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[5] Obviously, each lessor in Philco engaged in activities that linked it with Illinois much more closely than merely knowingly entering into a contract for the lease of goods to persons who would use them in Illinois. I reduce the lessors' activities in Philco to their bare minimum only because this inquiry involves "minimum contacts" sufficient to satisfy due process.

Court still held that North Dakota's attempt to exact tax from Quill satisfied due process because Quill's purposefully directed its considerable solicitation activities into that state.

Moreover, in both Asahi and Hanson v. Denckla, 357 U.S. 235, 253, 78 S.Ct. 1228, 1239, 2 L.Ed.2d 1283 (1958), the Supreme Court held that whether a state's claim of personal jurisdiction satisfies due process depends on the actions of the defendant itself, and not upon the independent acts of others. A defendant's ability to merely foresee that another might bring the defendant's goods into a forum state does not constitute a defendant's purposeful direction of activities toward that particular state. Asahi, 480 U.S. at 112, 107 S.Ct. at 1032. Yet that is just what the Department argues in its brief. Department's Brief, pp. 9 ("by virtue of its very business the Taxpayer invoked the benefits and protections of the laws of Illinois."), 11 ("[ABC] holds itself out as being engaged the business of leasing airplanes …. This particular leasing activity [ ] leads to inherently ABC activity. The Taxpayer named itself 'ABC Leasing'; implicit in the naming of their company and the nature of its business was that the Taxpayer's equipment was going to travel among the states."). The Department's stance, therefore, seems to be that any lessor of movable goods, anywhere, who leases such goods to a lessee that subsequently brings them into Illinois for use, is subject to Illinois use tax on the lessor's depreciated cost price of the leased goods, regardless whether the lessor knew that the lessee would be using them in Illinois or not.

I cannot read the Illinois supreme court's interpretation of "use" in Philco to mean what the Department suggests it means. More importantly, the Department's essential argument — that a lessor's introduction of its leased goods into the stream of commerce subjects the lessor to the personal and judicial jurisdiction of any state into which such

goods might foreseeably end up — was implicitly rejected by the United States Supreme Court in Asahi. Asahi, 480 U.S. at 112, 107 S.Ct. at 1032.

Nor has the Department articulated how, if ABC *did not know* that XYZ would be using its aircraft in Illinois, ABC's after-the-fact acquisition of such knowledge should be understood to constitute its purposeful direction of activities toward Illinois. "Purposefully," after all, means with a purpose, and "purpose" denotes intent. *See* American Heritage Dictionary of the English Language, Fourth Edition (2000) ("purpose" defined as "1. The object toward which one strives or for which something exists; an aim or a goal …. 2. A result or effect that is intended or desired; an intention.") (online version, at http://www.dictionary.com). Thus, even if one discounts the legal effect of the Court's decision in Asahi, and approaches the issue as a simple question of fact, ABC's stipulated act of knowingly leasing goods to XYZ does not necessarily translate into its knowing lease of goods to XYZ for use in Illinois. It is only the latter that subjects an out-of-state lessor to Illinois use tax. *See* Philco, 40 Ill. 2d at 317-18, 239 N.E.2d at 809. Again, nothing within this record establishes that ABC had any knowledge that XYZ intended to use its aircraft in Illinois — or that it was even *in* Illinois — until such time as XYZ redelivered the aircraft to ABC, and ABC had an opportunity to examine the aircraft log. Stip. p. 3, ¶ 2; Stip. Exs. 5-6.

After considering all of the stipulations, exhibits and the other evidence contained in the parties' stipulated record, I conclude that ABC has rebutted the Department's prima facie determination that ABC leased its aircraft for use in Illinois. There is no evidence to show that ABC purposefully directed any solicitation or economic activities toward Illinois or its residents, or that it knew, prior to the end of the lease with XYZ,

that XYZ would be using ABC's aircraft in Illinois. After a taxpayer rebuts the Department's prima facie case, the burden shifts back to the Department to prove its case by a preponderance of the evidence. Goldfarb v. Department of Revenue, 411 Ill. 573, 580, 104 N.E.2d 606, 609 (1952). Here, the Department offered no competent evidence to support its determination that ABC knowingly leased goods for use in Illinois, and that it was, therefore, subject to Illinois use tax.

Issue III: Whether Illinois' Taxation of ABC's Use Of Its Aircraft Interferes With Interstate Commerce

The Supreme Court's Quill decision effectively adopted the reasoning of Justice Rutledge opinion in International Harvester Co., that, "If there is a want of due process to sustain the tax, by that fact alone any burden the tax imposes on the commerce among the states becomes 'undue.' " Quill, 504 U.S. at 305-06, 112 S.Ct. at 1909 (*quoting* International Harvester Co., 322 U.S. at 353, 64 S.Ct. at 1032-33 (Rutledge, J., concurring in part and dissenting in part)). Since there is no evidence in the record to show that when it leased its airplane to XYZ, ABC purposefully directed acts toward Illinois, its residents, or its economy, ABC also lacks substantial nexus with Illinois, under the Commerce Clause. *Id*.

Conclusion:

I recommend that the Director cancel the NTL.

Date: 11/14/2002

John E. White
Administrative Law Judge